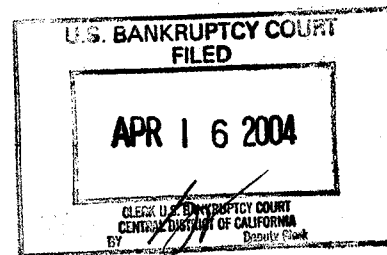


FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re) Case No. SA 00-19215 JR
FLASHCOM, INC.,) Adv. No. SA 02-1620 JR
Debtor.) Chapter 11

CAROLYN A. DYE, Liquidating)
Trustee,)
Plaintiff,)
vs.)

MEMORANDUM OPINION

ANDRA SACHS; COMMUNICATIONS)
VENTURES III, LP; COMMUNICATIONS)
VENTURES III CEO & ENTREPRENEURS')
FUNDS LP; MAYFIELD IX; MAYFIELD)
ASSOCIATES FUNDS IV; DAVID HELFICH;)
TODD BROOKS; BRADFORD SACHS;)
RICHARD RASMUS; and KEVIN FONG,)
Defendants.)

Date: April 8, 2004
Time: 9:30 A.M.
Courtroom: 5A

I. INTRODUCTION

After filing a chapter 11¹ petition, Flashcom, Inc.
("Debtor") filed a plan of reorganization that was confirmed on

¹ Unless otherwise indicated, all chapter, section, and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

1 December 11, 2001. Debtor's plan made Carolyn Dye ("Trustee")
2 liquidating trustee for Debtor's estate.

3 On July 11, 2002, Trustee filed a complaint (the "Complaint")
4 against the defendants listed above ("Defendants"). Defendants
5 filed a motion for partial summary judgment (the "Motion"),
6 asserting that the California Corporations Code ("CCC") does not
7 apply to the claims asserted in the Complaint as a matter of law.
8 Trustee opposed the Motion. After the hearing on April 8, 2004, I
9 took the matter under submission.

10 11 II. JURISDICTION

12 I have jurisdiction over this matter under 28 U.S.C.
13 § 157(b)(1). This is a core proceeding under the Bankruptcy Code,
14 as defined in 28 U.S.C. § 157(b)(2)(A), (F), (H) and (O).

15 16 III. STATEMENT OF FACTS

17 The Complaint alleges the following: Defendants either
18 orchestrated or participated in certain unauthorized, improper, or
19 otherwise avoidable agreements and transfers (the "Agreements and
20 Transfers") with Debtor between September 1999 and February 2000.
21 Most significantly, Debtor improperly redeemed stock held by Andra
22 Sachs for \$9 million (the "Stock Redemption") on February 23,
23 2000.

24 Also, David Helfrich, Todd Brooks, Bradford Sachs, Andra
25 Sachs, Richard Rasmus, and Kevin Fong were members of Debtor's
26 board of directors. Communications Ventures III, LP and
27 Communications Ventures III CEO & Entrepreneurs Fund LP (the "CV
28 Defendants") were shareholders of Debtor and were controlled by

1 Helfrich. Mayfield IX and Mayfield Associates Funds (the
2 "Mayfield Defendants") were shareholders of Debtor and were
3 controlled by Brooks and Fong.

4 The Complaint includes claims for (1) avoidance and recovery
5 of unauthorized corporate agreements and payments under CCC § 310,
6 Delaware law, and other applicable non-bankruptcy law (the "Fifth
7 Claim"); (2) avoidance and recovery of improper corporate
8 agreements and payments under CCC §§ 501-503, 506, and 2115 (the
9 "Seventh Claim"); (3) breach of fiduciary duty by Debtor's
10 directors and officers under CCC §§ 315-317 and 2115-2116, and
11 Delaware law (the "Tenth Claim"); (4) negligence and corporate
12 waste under CCC §§ 315-317 and 2115-2116, and Delaware law (the
13 "Eleventh Claim"); and (5) liability for unlawful dividends,
14 purchase, or redemption under CCC §§ 316 and 2115-2116, and
15 Delaware law (the "Twelfth Claim").

16 The CV Defendants, the Mayfield Defendants, Helfrich, Brooks
17 and Fong ("Movants") seek partial summary judgment, arguing that
18 the CCC did not apply to Debtor at the time the Agreements and
19 Transfers occurred. Movants argue that CCC § 2115, which makes
20 certain provisions of California law² applicable to foreign
21 corporations if certain requirements³ are met over a specified
22

23 ² The CCC sections listed under CCC § 2115(b) include: § 316
24 (liability of directors for unlawful distributions), § 317
25 (indemnification of directors, officers, and others), §§ 500 to 505
26 inclusive (limitations on corporate distributions in cash or
property), and § 506 (liability of shareholder who receives
unlawful distribution). See Cal. Corp. Code § 2115(b).

27 ³ In general terms, the requirements measure the extent of a
28 foreign corporation's activity in California. This "three-factor
formula" includes a property factor, a payroll factor, and a sales
factor, as those terms are defined in the California Revenue and
Taxation Code. See Cal. Corp. Code § 2115(a).

1 period of time,⁴ was not triggered by Debtor until January 1,
2 2001, after the Agreements and Transfer took place. Accordingly,
3 Movants contend that they are entitled to partial judgment on
4 those claims in the Complaint that are based on CCC
5 § 2115.

6 Additionally, Movants assert that as a Delaware corporation,
7 the doctrine of internal affairs requires the application of
8 Delaware law to issues of Debtor's internal affairs, including the
9 Agreements and Transfers. Therefore, Movants argue that CCC
10 §§ 310 and 315 do not apply to Debtor and that summary judgment on
11 those claims is appropriate. Andra Sachs joins the Motion.

12 In opposition, Trustee argues that the trigger date for the
13 application of CCC § 2115 to Debtor was January 1, 2000, prior to
14 the Stock Redemption. Trustee also asserts that the internal
15 affairs doctrine does not apply under these circumstances given
16 Debtor's extensive activities in California. Accordingly, Trustee
17 argues that her claims based on California law should stand.

18 The following facts are undisputed:

- 19 1) Debtor was first incorporated in Nevada on May 19, 1998;
- 20 2) Debtor was reincorporated in Delaware on January 20, 1999;
- 21 3) Debtor was operating as a foreign corporation in
22 California at all relevant times;
- 23 4) Debtor's fiscal year is set as the calendar year; and
- 24 5) Just for the Motion, Debtor's activity in California
25 satisfied the three-factor formula under 2115(a) at all
26

27 ⁴ Under CCC § 2115(a), the three-factor formula must be met
28 for a "full income year." Subdivision (d) then provides a trigger
date for the application of the CCC sections specified in
subdivision (b). See Cal. Corp. Code § 2115(a).

1 relevant times.

3 IV. DISCUSSION

4 1. The Application of CCC § 2115

5 CCC § 2115 provides in relevant part:

6 (a) A foreign corporation . . . is subject to
7 the requirements of subdivision (b) commencing
8 on the date specified in subdivision (d) and
continuing until the date specified in
subdivision (e) if:

9 (1) the average of the property factor, the
10 payroll factor, and the sales factor (as
11 defined in Sections 25129, 25132, and 25134 of
12 the Revenue and Taxation Code) with respect to
it is more than 50 percent during its **latest
full income year** and

13 (2) more than one-half of its outstanding
14 voting securities are held of record by
15 persons having addresses in this state
16 appearing on the books of the corporation on
17 the record date for the latest meeting of
18 shareholders held during its latest full
19 income year or, if no meeting was held during
20 that year, on the last day of the latest full
21 income year. The property factor, payroll
22 factor, and sales factor shall be those used
23 in computing the portion of its income
24 allocable to this state in its franchise tax
25 return or, with respect to corporations the
26 allocation of whose income is governed by
27 special formulas or that are not required to
28 file separate or any tax returns, which would
have been so used if they were governed by
this three-factor formula.

22

23 (d) For purposes of subdivision (a), the
24 requirements of subdivision (b) shall become
25 applicable to a foreign corporation only upon
26 the first day of the first income year of the
27 corporation (1) commencing on or after the
28 135th day of the income year immediately
following the latest income year with respect
to which the tests referred to in subdivision
(a) have been met or (2) commencing on or
after the entry of a final order by a court of
competent jurisdiction declaring that those
tests have been met.

1 Cal. Corp. Code § 2115 (emphasis added). Here, the only issue
2 pertaining to the application of CCC § 2115 is when the trigger
3 date under subsection (d) occurred. The statute is clear that the
4 three-factor formula under subdivision (a) must be met for a "full
5 income year" before the trigger date can be determined under
6 subdivision (d).

7 Movants argue that the term "full income year" means a full
8 calendar or fiscal year. Under this interpretation, Debtor
9 satisfied subdivision (a) in 1999,⁵ causing the 135-day count to
10 begin on January 1, 2000, thereby making January 1, 2001 the
11 trigger date under subdivision (d).

12 Trustee argues that the term "income year" under subdivision
13 (d) does not require a full fiscal or calendar year. Rather,
14 Trustee asserts that the income year requirement is met by the
15 period from May 19, 1998 to December 31, 1998, or by the period
16 from May 19, 1998 to May 19, 1999. In either case, the trigger
17 date under subdivision (d) would then be January 1, 2000, prior to
18 the Stock Redemption on February 23, 2000.

19 No reported cases discuss the meaning of "full income year"
20 as used in CCC § 2115. However, the three-factor formula under
21 subdivision (a) is based on data "used in computing the portion of
22 [the foreign corporation's] income allocable to this state in its
23 franchise tax return" Cal. Corp. Code 2115(a)(2).
24 Section 2115(a)(1) also states that the three factors are defined
25

26
27 ⁵ Although Debtor began its operations in May 1998, Debtor's
28 fiscal year was set as the calendar year, making the period from
May to December 1998 less than a full calendar or fiscal year.
Therefore, Debtor's first full fiscal year was 1999.

1 in the California Revenue and Taxation Code. For the purposes of
2 calculating franchise taxes, the term "income year" is defined as
3 "the calendar year or the fiscal year upon the basis of which the
4 net income is computed." Cal. Rev. & Tax. Code § 23042.

5 Indeed, the only workable definition of "full income year" as
6 used in CCC § 2115 is a full calendar or fiscal year.⁶ A foreign
7 corporation must apply the three-factor formula to its activities
8 in California using data from its franchise tax return. Franchise
9 taxes are payable for every "taxable year," which is also defined
10 as a calendar year or fiscal year. Id. § 23041. Therefore, a
11 foreign corporation cannot determine whether its activity in
12 California satisfies the three-factor formula for a full income
13 year without data from a full fiscal or calendar year.

14 The California Court of Appeal has explained:

15
16 In construing statutory language, our
17 fundamental task is to ascertain the intent of
18 the lawmakers so as to effectuate the purpose
19 of the statute. We begin by examining the
20 statutory language, giving the words their
usual and ordinary meaning. If there is no
ambiguity, then we presume the lawmakers meant
what they said, and the plain meaning of the
language governs.

21 People v. Connor, 115 Cal. App. 4th 669, 678 (2004); see also
22 Great Lakes Props., Inc. v. City of El Segundo, 19 Cal. 3d 152,
23 155 (1977) (stating that unless a term is specifically defined by
24

25 ⁶ The limited secondary authority interpreting CCC § 2115 has
26 also found that the term "income year" refers to the calendar year
27 or fiscal year upon which a foreign corporation computes its net
28 income and franchise taxes. See 2 Marsh, Marsh's California
Corporation Law, § 26.04[c], 26-86 (4th ed. 2000); see also
Ballantine & Sterling, California Corporaton Laws, § 393.04 (2003).

1 statute, or it is clearly shown that a different meaning was
2 intended, the plain meaning governs). Here, "calendar year" is
3 not defined under the CCC or the California Revenue and Taxation
4 Code. However, "[t]he literal meaning of the term 'calendar year'
5 is the period of twelve months between January 1 and December 31."
6 Jensen v. Johnson County Youth Baseball League, 838 F. Supp. 1437,
7 1441 (D. Kan. 1993) (citing Bonray Oil Co. v. Dep't of Energy, 472
8 F. Supp. 899, 902 (D. Okla. 1978)). Accordingly, the term "full
9 income year" as used in CCC § 2115 means a full fiscal year or
10 twelve-month period from January 1 to December 31.

11 Here, Debtor's fiscal year was set as the calendar year.
12 Therefore, Debtor's first full fiscal year, or first "full income
13 year," was 1999. For purposes of the Motion, the parties agree
14 that Debtor's activity in California in 1999 satisfied the three-
15 factor formula. Under subdivision (d), the 135-day period began
16 to run on January 1, 2000 and expired on May 13, 2000, making
17 January 1, 2001 "the first day of the first income year . . .
18 commencing on or after the 135th day" Therefore, January
19 1, 2001 was the trigger date for the application of CCC § 2115 to
20 Debtor.

21 The Agreements and Transfers took place no later than
22 February 2000. Therefore, Debtor was not subject to the
23 provisions of the CCC listed under CCC § 2115(b) at the time the
24 Agreements and Transfers occurred. Accordingly, Movants are
25 entitled to judgment on the Seventh, Tenth, Eleventh, and Twelfth
26 Claims, to the extent brought under CCC § 2115.
27
28

1 2. The Internal Affairs Doctrine

2 A California court describes the internal affairs doctrine
3 as:

4 [A] conflict of laws principle which
5 recognizes that only one State should have the
6 authority to regulate a corporation's internal
7 affairs-matters peculiar to the relationships
8 among or between the corporation and its
9 current officers, directors, and
10 shareholders-because otherwise a corporation
could be faced with conflicting demands.
States normally look to the State of a
business' incorporation for the law that
provides the relevant corporate governance
general standard of care.

11 State Farm Mut. Auto. Ins. Co. v. Superior Court, 114 Cal. App.
12 4th 434, 442 (2003) (quoting Edgar v. MITE Corp., 457 U.S. 624,
13 645 (1982) and Atherton v. FDIC, 519 U.S. 213, 224 (1997)). "In
14 general, courts in California follow this rule and apply the law
15 of the state of incorporation in considering claims relating to
16 internal corporate affairs." In re Sagent Tech., Inc., 278 F.
17 Supp 2d 1079, 1087 (N.D. Cal. 2003). Indeed, the internal affairs
18 doctrine, as applied to director liability, has been codified in
19 California. See Cal. Corp. Code § 2116.

21 This does not mean that California has no role in governing
22 the conduct of foreign corporations. Clearly, California law
23 applies to conduct unrelated to the internal affairs of a foreign
24 corporation. See Valtz v. Penta Inv. Corp., 139 Cal. App. 3d 803,
25 807 (1983) (applying California law to a shareholder's demand to
26 inspect a foreign corporation's records and noting that such
27 activity is not an internal corporate affair); Western Air Lines,
28 Inc. v. Sobieski, 191 Cal. App. 2d 399, 409-10 (1961) (holding

1 that a foreign corporation must comply with California securities
2 laws when entering into stock transactions with California
3 residents and noting that such activity is not an internal
4 affair). Additionally, California law may apply to the internal
5 affairs of a foreign corporation under a specific statute. See
6 Havlicek v. Coast-to-Coast Analytical Servs., Inc., 39 Cal. App.
7 4th 1844 (1995) (applying California law to a director's right to
8 inspect a foreign corporation's records under CCC § 1602); Wilson
9 v. Louisiana-Pacific Res., Inc., 138 Cal. App. 3d 216 (1982)
10 (rejecting a constitutional challenge to CCC § 2115 as applied to
11 a foreign corporation).

12
13 Here, Debtor is a foreign corporation incorporated in
14 Delaware. Trustee does not dispute that the Agreements and
15 Transfers involve the internal affairs of Debtor. Additionally,
16 as discussed above, the trigger date under CCC § 2115(d) occurred
17 after the Agreements and Transfers took place. Finally, Trustee
18 has not identified any other specific statute in the Complaint
19 applying the CCC to the conduct of a foreign corporation.
20 Therefore, Delaware law governs the Agreements and Transfers, and
21 Movants are entitled to judgment on the Fifth, Seventh, Tenth,
22 Eleventh, and Twelfth Claim, to the extent brought under the CCC.

23 24 25 V. CONCLUSION

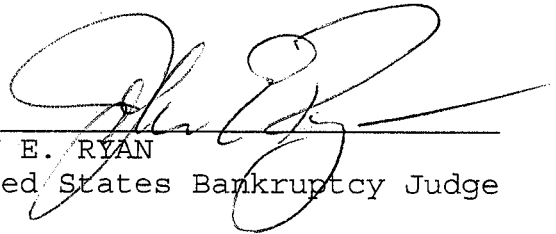
26 The plain language and practical application of CCC § 2115
27 show that the term "full income year" as used in subdivision (a)
28 means a full fiscal year or twelve-month period from January 1 to

1 December 31. Debtor's first full fiscal year was 1999, making
2 January 1, 2001 the trigger date under subdivision (d).

3 With several statutory exceptions, including CCC § 2115, the
4 law of the state of incorporation governs the internal affairs of
5 a corporation. Here, Debtor was incorporated in Delaware and
6 operated as a foreign corporation in California. Additionally,
7 CCC § 2115 and the provisions listed therein did not apply to
8 Debtor until after the Agreements and Transfers took place.
9 Therefore, Delaware law governs the internal affairs of Debtor
10 during the relevant period, and partial summary judgment on the
11 Fifth, Seventh, Tenth, Eleventh, and Twelfth Claims, to the extent
12 brought under the CCC, is appropriate.
13

14 This memorandum opinion shall constitute my findings of fact
15 and conclusions of law.

16 Dated: April 16, 2004
17

18 
19 JOHN E. RYAN
20 United States Bankruptcy Judge
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